DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 98-0309
Use Tax
For Tax Periods 1993-1996

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ISSUES

I. Use Tax—Allocated General Expenses

Authority: IC 6-2.5-4-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-2

Taxpayer protests imposition of sales tax on general expenses paid to parent company.

II. Use Tax—Allocated Occupancy Charges

Authority: IC 6-2.5-4-4; 45 IAC 2.2-4-8

Taxpayer protests imposition of sales tax on occupancy charges paid to parent company.

III. Tax Administration—Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of buying, selling and holding educational loans. Taxpayer was incorporated in 1992 as a not-for-profit corporation, and applied for federal recognition of its exemption status in 1993. Taxpayer withdrew its application for exempt status in 1995. At that point, taxpayer filed financial institution tax returns to cover the period from its inception through the present. No use tax was paid with the returns.

In 1993 and 1994, taxpayer's parent company was a not-for-profit entity, and served as a common purchasing arm for its subsidiaries. In 1995 taxpayer was transferred from the

first parent company to a second parent company. The second parent company was a taxable entity. The Indiana Department of State Revenue ("Department") conducted an audit of taxpayer covering tax years 1993 through 1996. The Department assessed use tax on items purchased by the parent corporations but used by taxpayer.

I. Use Tax—Allocated General Expenses

Taxpayer protests imposition of use tax on various administrative fees paid by taxpayer to its parent companies. The Department assessed use tax on taxpayer's allocated expenses exclusive of occupancy, including printing, copying, data processing and asset costs. These expenses were recouped by the parent companies through the administrative fees. Taxpayer believes the administrative fees are not subject to tax because they are for the provision of nontaxable services. Taxpayer refers to IC 6-2.5-4-1(e), which states:

> The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
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> (1) the price of the property transferred, without the rendition of any service; and
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> (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

Taxpayer states the services provided by its parent are not enumerated as taxable under Indiana law and any tangible personal property transferred with the provision of these services are inconsequential.

In determining the use tax assessment for taxpayer, the Department relied on 45 IAC 2.2-3-4, which states:

> Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Since the original parent company is a not-for-profit entity, no gross retail tax was collected at the point of purchase and the items were used or otherwise consumed in Indiana. The second parent company is a for-profit entity, but it purchased supplies outside of Indiana, therefore no gross retail tax was collected on those items at the point of purchase and the items were used or otherwise consumed in Indiana.

Taxpayer claims the amount of tangible personal property transferred from its parent was inconsequential, under ten percent (10%), and was therefore exempt. The relevant regulation is 45 IAC 2.2-4-2(a), which states:

> Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
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> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; *and*
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. (Emphasis added)

On its face, this exemption does not apply. All four elements must be satisfied for this exception to apply. It has been established that the parent companies did not pay gross retail tax or use tax on the tangible personal property at the time of acquisition.

At hearing, taxpayer asked who would collect the tax if the parent companies were not required to be listed as a retail merchant in order to collect the use tax from taxpayer. Taxpayer confuses the issue. The parent companies were not selling items to taxpayer; rather, the parent companies were purchasing items on behalf of the subsidiary.

The situation of the taxpayer and its parent corporations suggests the existence of an agency relationship in which the parent corporations obtained tangible personal property tax-free for the taxpayer's use which reimbursed the parent for the goods. Since the taxpayer is not an exempt entity, it should have paid sales or use tax on the goods purchased.

FINDING

Taxpayer's protest is denied.

II. Use Tax—Occupancy Allocations

Taxpayer protests imposition of use tax on various direct and indirect occupancy charges paid to the parent company. The Department assessed the direct occupancy charges based on the amount paid by taxpayer to the parent for building supplies, utilities and office maintenance. Taxpayer believes that the direct occupancy charges are substantively building rental charges and are exempt under IC 6-2.5-4-4, which states in pertinent part:

(a) A person is a retail merchant making a retail transaction when the person rents or furnishes rooms, lodgings, or other accommodations, such as booths, display spaces, banquet facilities, and cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment to another person:
(1) if those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days;

Taxpayer believes that since the accommodations are rented for more than thirty days, they are exempt. A more succinct description of this exemption is found in 45 IAC 2.2-4-8(b), which states:

> In general, the gross receipts from renting or furnishing accommodations are taxable. An accommodation which is rented for a period of thirty (30) days or more is not subject to the gross retail tax.

Taxpayer is correct that rental expenses for the offices it rents from the parent company are exempt, since they are rented for more than thirty days. The Department did not assess use tax on the rental costs allocated to taxpayer.

The assessment for direct occupancy charges included building supplies, utilities and office maintenance. The costs of office maintenance were reduced by fifty percent (50%) to exclude the costs of labor.

Taxpayer believes that the indirect occupancy charges are building management fees which are non-taxable services as explained in Issue I of this protest. As explained in Issue I, the nature of the relationship between taxpayer and the parent company is one where the parent is purchasing tangible personal property free of tax, as a not-for-profit organization, on behalf of taxpayer, which is a for-profit corporation.

Taxpayer states in its protest letter that at no time is the parent company selling building supplies, utilities or office maintenance to taxpayer, but only allocates the charges on its records to help it track its costs. As previously established, the parent is not selling theses items, but rather is purchasing items on behalf of its non-exempt subsidiary.

FINDING

Taxpayer's protest is denied.

III. Tax Administration—Negligence Penalty

Taxpayer protests imposition of a ten percent (10%) negligence penalty. Taxpayer was assessed use tax on direct purchases made for it by its parent corporation, and did not protest this assessment. Taxpayer believed the allocated expenses were for services, which would not be taxable. The Department waived penalties for the first two years of

this audit, on the grounds that taxpayer was making a good faith effort to gain not-for-profit status from the federal government during those years.

The relevant regulation is 45 IAC 15-11-2(c), which states in part:

> The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has not demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay sales tax. Once taxpayer was no longer seeking not-for-profit status, it should have known that it could not receive tangible personal property from its not-for-profit parent company without paying use tax. Therefore, taxpayer has not affirmatively established reasonable cause.

FINDING

Taxpayer's protest is denied.

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